P&L

Paducah & Louisville Railway, Inc.
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February 26, 2007

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VIA E-FILING

The Honorable Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street, N.W.
Washington, DC 20423-0001

Re: STB Ex Parte No. 646 (Sub-No. 1)
Simplified Standards For Rail Rate Cases

Dear Secretary Williams:

As provided for in previous Surface Transportation Board decisions issued in the above-captioned proceeding, Paducah & Louisville Railway, Inc. ("P&L") hereby submits, via e-filing, its comments on the issues raised in this proceeding. If there are any questions concerning this e-filing, please contact me by telephone at (270) 444-4430 or by email at jtgarret@palrr.com

Sincerely,

J. Thomas Garrett

J. Thomas Garrett

Enclosures

BEFORE THE
SURFACE TRANSPORTATION BOARD

EX PARTE NO. 646 (SUB-NO. 1)

SIMPLIFIED STANDARDS FOR RAIL RATE CASES

COMMENTS OF THE PADUCAH & LOUISVILLE RAILWAY, INC.

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Dated: February 26, 2007

BEFORE THE
SURFACE TRANSPORTATION BOARD

EX PARTE NO. 646 (SUB-NO. 1)

SIMPLIFIED STANDARDS FOR RAIL RATE CASES

COMMENTS OF THE PADUCAH & LOUISVILLE RAILWAY, INC.

INTRODUCTION

On January 31, 2007, the Surface Transportation Board ("Board") held a hearing in connection with its proposal to modify to the so-called "Simplified Guidelines" for rail rate cases "in which a full stand-alone cost ("SAC") presentation would be too costly, given the value of the case." July 28, 2006 Decision at 3 (quoting 49 U.S.C. 10701(d)(3)). In announcing this hearing, the Board stated that it would leave the record in this proceeding open until February 26, 2007, so that all interested parties may submit supplemental comments on issues raised in the proceeding and at the hearing.

Paducah & Louisville Railway, Inc. ("P&L")[1] respectfully submits these comments, having been motivated to do so because of issues discussed at the Board's January 31 hearing and raised in written comments filed prior to the hearing. Although a party of record in this proceeding, P&L has

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[1] P&L is a Class II rail carrier that was formed in 1986 when it acquired certain lines from the Illinois Central Gulf Railroad Company. See Paducah & Louisville Railway, Inc. - Acquisition and Operation Exemption - Illinois Central Gulf Railroad Co., Finance Docket No. 30891, 51 Fed. Reg. 33148 (1986). P&L owns and operates approximately 309 miles of rail lines located between Paducah, Kentucky and Louisville, Kentucky. The leading commodities shipped by P&L are coal and chemicals, which collectively account for more than seventy-five percent of P&L's revenues.

not previously submitted comments. Having reviewed the record, however, P&L is deeply concerned about the negative impacts the proposed Simplified Guidelines revisions (generally referred to herein alternatively as the "guidelines" or "standards") could have upon regional and short line carriers, including, of course, P&L. P&L's concerns are shared by P&L's sister companies, Evansville Western, Inc. and Appalachian and Ohio Railway, Inc., who, like P&L, haul a significant amount of non-exempt commodities that would be subject to the guidelines.

As a general matter, P&L questions whether the Board needs to modify its existing Simplified Guidelines. Those guidelines have been successfully invoked by shippers, and the rate cases initiated under them have been settled through mediation.[2] Because shippers are beginning to pursue remedies under the existing guidelines, and because such disputes have been resolved through mediation (which is something that cannot yet be said of any cases handled under the full SAC methodology), the Board's small rate remedies are available, usable, and generally yield to mediated solutions without the need for formal and costly processes. In fact, these developments undercut the idea that the existing guidelines are inaccessible, do not already influence rail carriers when setting or negotiating rates, or that the Board has not already satisfied its congressional mandate under section 10701(d)(3). As such, P&L believes the Board has already established "a simplified and expedited method for determining the reasonableness of challenged rail rates" for cases where a full SAC case is prohibitively expensive and that it need not change those guidelines, especially when doing so creates more problems than they would resolve.

Realizing that the Board may nonetheless continue to move forward with its current proposal, P&L is concerned that the revised standards could adversely affect Class II and III carriers

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[2] Williams Olefins, LLC v. Grand Trunk Corporation, STB Docket No. 42098; BP Amoco Chemical Company v. Norfolk Southern Railway Company, STB Docket No. 42093.

in ways that railroads such as P&L are just beginning to comprehend. Indeed, for the most part, shortline and regional railroads have to this point been too removed from this proceeding, perhaps because they, like P&L, are only beginning to appreciate the possible ramifications of the proposed standards and the unintended but very real prejudices against smaller carriers that they contain.

This lack of involvement is understandable. For several short line railroads, the proposed guidelines may have little day-to-day impact in their business decisions. Frequently, smaller railroads collect per-car allowances based on the line-haul rates assessed by the connecting Class I. In such cases, the short line railroad may never even appear in the waybill. Where smaller carriers lack independent ratemaking authority, the Board's proposal would not have any significant impact, because the Class I carrier would be the sole defendant in the proceeding and a rate prescription probably would not affect the short lines' allowances. However, a substantial number of regional and short line carriers, like P&L, have independent ratemaking authority and can and do set rates jointly with, or independently from, their Class I partners, and handle local movements of non-exempt commodities (movements that both originate and terminate on their systems). Such carriers would be equally, if not more, prone than are larger railroads to have their rates challenged under the new guidelines.[3] These regional and shortline carriers are most threatened by the Board's proposal, and yet little regard seems to have been given to such impacts in the current record. P&L hereby submits these comments to correct that deficiency.

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[3] Given the relative disparity in size between smaller Class II and III carriers and the frequently much larger shippers they serve, P&L is concerned that the Board's revised standards would be an invitation to larger shippers to "test the waters" by first focusing litigation on smaller carriers with fewer resources with which to defend themselves in order to develop favorable precedents under the guidelines before using the guidelines to complain against the rates set by the Class I's.

I. THE USE OF UNADJUSTED URCS WILL UNDERSTATE COSTS AND PREVENT P&L FROM RECOVERING ITS FULLY ALLOCATED COSTS

The problem with applying the proposed guidelines to carriers like P&L who have independent ratemaking authority but whose operations tend to consist of a significant amount of time-intensive activities, such as switching, terminal handling, and short-haul movements, has been discussed in the comments of The Kansas City Southern Railway Company ("KCSR"). As KCSR has observed, the proposal's heavy reliance upon the Uniform Rail Costing System ("URCS") and its prohibition of movement-specific adjustments to URCS would have several adverse consequences. In large part, this is due to the fact that URCS understates the costs incurred by carriers like KCSR, P&L, and other similarly situated carriers.

The problems with URCS noted by KCSR are even more significant and problematic in cases involving smaller, non-Class-I railroads, such as P&L, whose economic data is used very little, if at all, in calculating URCS costs. As elaborated upon in the attached verified statement of Dr. William J. Brennan, PhD, applying URCS's regional average costs (which presumably would have to be used if a carrier such as P&L became a defendant in a rail rate case) would actually *understate* P&L's costs. As such, applying the simplified guidelines to P&L would unlawfully allow certain rate challenges to proceed and yield prescribed rates that are below the regulatory threshold or at levels below that required for P&L to maintain adequate revenues and recover its cost of capital. As the Canadian carriers and others have also pointed out, these problems are further compounded in situations where the issue traffic is hazardous chemicals; preventing carriers from recouping these additional costs.

Dr. Brennan explains that while smaller carriers such as P&L may be viewed as "lower cost alternatives" to their Class I partners, suggesting that the use of unadjusted URCS – which draws in large part upon data from the alleged "higher cost" Class I railroads – would help defendant short lines by overstating their actual costs, that assumption is incorrect. Instead, URCS likely understates P&L's costs and the costs of other Class II and Class III carriers. . Dr. Brennan shows that, for most movements, Class I railroads (who provide longer-haul service over higher-density lines) are the lower cost providers of service vis-à-vis shortline and regional railroads. This is a result of the economies of scale, scope, and density that Class I carriers typically enjoy. As KCSR's comments have borne out, however, URCS does not accurately reflect the costs of railroads that have shorter average lengths of haul like KCSR, shortlines, and regionals. This inaccuracy occurs because short-haul traffic typical of shortlines and regionals is comparatively more time-sensitive than mileage-sensitive,[4] while URCS allocates costs predominantly based on mileage.

This problem for smaller railroads is further compounded by the fact that some of the URCS's inputs are not carrier-specific, such as the cost of capital, which derives entirely from economic data supplied to the Board by much larger Class I railroads. And it is even further exacerbated by the fact that URCS lacks a sufficient sample of shortline and regional railroad costs to provide suitable cost averages. Consequently, applying Class I-based URCS data to cost movements on P&L in the event of a rate challenge would substantially understate P&L's true costs. For these reasons, the Board should consider whether it would be appropriate not to apply its proposed guidelines to smaller carriers like P&L. If the Board should after careful consideration of the points raised here decide nevertheless to apply the proposed new standards to smaller railroads, then the Board ought at least to recognize the severe limitations of unadjusted URCS, and to allow smaller defendant railroads to provide evidence in support of movement-specific adjustments to reflect the true costs of service and to make adjustments accordingly.

[4] As Dr. Brennan states, by allocating most costs to mileage-based categories, URCS much more faithfully resembles the operating characteristics of Class I carriers and the long-haul traffic that typifies those railroads.

In addition to the likelihood that the Class I-oriented URCS system would substantially understate smaller railroads' actual costs unless appropriate movement-specific adjustments to URCS are allowed, there is another problem with URCS that applies equally to all rail carriers. Specifically, as commenters such as Canadian National Railway Company ("CN") and Canadian Pacific Railway Company ("CP") have pointed out, URCS may exclude, and grossly understates, the higher handling and liability costs associated with transporting hazardous materials.[5] This is a glaring deficiency in URCS and poses a tremendous problem for all carriers who, like P&L, transport hazardous materials and who might be required to defend hazardous materials transportation rates at a time when the federal government is proposing a host of new and potentially quite costly regulations directed to the transport of hazardous cargoes by rail. Chemical traffic represents a large portion of P&L's revenues, so P&L joins with CN, CP, and other carriers in urging the Board to allow adjustments to URCS as necessary to capture the true costs of transporting this traffic. Were its rates to be challenged and were the Board to use unadjusted URCS as the primary means by which to analyze and prescribe rates, P&L would be unable to account for the significantly higher costs of transporting hazardous materials and would prevent P&L from covering its fully accounted costs.

In light of the problems associated with applying URCS to short-haul movements, the fact that URCS does not accurately account for short line costs, especially with respect to the transportation of hazardous materials, the Board should either – remove smaller carriers from the scope of the proposed guidelines, or, barring that, recognize the importance of movement specific adjustments to URCS. If the Board makes no such provision for URCS adjustments, then P&L submits that the Board will have created a system highly prejudicial to smaller carriers at the

[5] See, e.g., CP Opening Comments at 12-14 and CN Rebuttal Comments at 3-7.

expense of expedience. Such a rigid arrangement seems to P&L to be a very arbitrary balancing of the underlying statutory objectives and policy considerations at play in this proceeding.

Finally, to the extent the Board chooses to apply the proposed guidelines (and, in particular the Three Benchmark methodology) to rate cases involving a Class II or III carrier, the Board should not to include traffic from Class I carriers in any comparison groups. By extension, the Board also should exclude from comparison groups traffic from other Class II and III carriers.[6] As other commenters have indicated, there are serious problems with the use of extra-carrier costs and economic data in rate proceedings. See, e.g., Union Pacific Railroad Company Opening Comments at 59-61; BNSF Railway Company Opening Comments at 39. Those problems would be even more insurmountable in the case of a short line defendant.

II. THE BOARD HAS NOT WEIGHED THE COSTS THAT ITS PROPOSED STANDARDS WOULD IMPOSE ON SHORT LINE AND REGIONAL RAILROADS

The proposed standards have been shaped to a very large degree by the agency's experiences in full SAC cases, which almost always have involved the largest of the Class I railroads. Indeed, it is apparent that the Board's staff has drawn from the Waybill Sample data to formulate and evaluate its proposals. But in formulating its proposal, to what degree, if at all, did the Board consider its standards in light of a rate challenge involving a defendant Class II or Class III carrier? The Board's July 28 Decision does not refer to or discuss Class II or III carriers at all. This is unfortunate given that the proposed guidelines would treat all railroad defendants the same,

[6] Given the Board's comments about how it might go about evaluating comparison traffic from other carriers using the "appropriate RSAM/(R/VC_{total}) ratio" (Notice of Proposed Rulemaking at 25 n. 45), it is entirely unclear how the Board would use such a method to assess comparison group traffic from non-defendant short lines and regional carriers.

despite the substantial economic differences between Class I railroads and their smaller Class II and III brethren.

Indeed, during the Board's hearing on January 31, Commissioner Buttrey commented about the need to adopt a rate complaint process that allows small shippers the opportunity to participate in the rate complaint process – a valid and understandable concern. But Commissioner Buttrey's comments would apply with equal validity had they also focused upon smaller railroads, which are small businesses themselves. The Board has conceived of different-sized rate cases to which it would apply different methodologies, but it should also recognize that there are differently-sized railroads (many much smaller in total revenues than the companies that they serve) that could be subjected to complaints under any of the processes that may be available to shippers. Just as the needs of small shippers should be considered, likewise, the needs of smaller carriers should also be addressed. The Board should not adopt new guidelines that impose substantial costs on small railroads simply to placate large shippers.

In this vein, the proposed guidelines fail to take into account the increased administrative costs that smaller railroads like P&L would bear in evaluating and revising internal costing and rate-making systems simply to comply with the proposed standards. For example, if the Board were to adopt its guideline modifications as proposed, P&L would have to assess how its costing practices comport with the applicable regional URCS average, especially if the Board prohibits movement-specific adjustments. Having previously had little reason to familiarize itself with URCS, the Board's modified standards immediately would require P&L to orient itself to a regulatory regime that would impose an essentially Class I costing system on smaller railroads. In addition, if the regional, unadjusted URCS average understates P&L's costs – Dr. Brennan's statement confirms that it does – then P&L would never be able to legally maximize its revenues, because it would be inclined to adjust its rates to avoid the possibility that certain rates, though actually reasonable, would appear to reflect market dominance. Likewise, any Board-prescribed rate would be set at artificially low levels, derived from an URCS system that understates P&L's true costs and prevents P&L from recouping those costs. Thus, applying unadjusted URCS to P&L movements would not only impose new administrative costs on P&L, but it would also unfairly deprive P&L of revenues that it is entitled to earn. Such an end-result of applying the proposed guidelines to smaller railroads is wholly inconsistent with the objectives of the Rail Transportation Policy at 49 U.S.C. 10101.

The Board's proposal would also have a disproportionate impact on smaller carriers when they are drawn into rate litigation alongside the larger railroads with which they cooperate to move traffic. For example, although generally handling the traffic for far shorter distances (and incurring more service-sensitive origination or termination costs in connection with its shorter haul), a smaller railroad such as P&L is equally responsible to defend against a rate complaint involving either (1) a joint rate offered in partnership with a Class I railroad; (2) the smaller carrier's separate rate as part of a multi-rate through service with one or more connecting Class Is; or (3) movements local to the smaller railroad. It is possible, indeed likely, that a smaller railroad defendant would incur litigation costs far in excess of the proportion of revenues that it earns for such traffic. P&L therefore urges the Board to carefully consider whether its guideline modifications would impose proportionally higher burdens on smaller carriers than any other stakeholders in these proceedings.

Given the lack of any discussion about the impacts of the proposed guidelines on smaller railroads, it appears that the Board has given short shrift to the issue. In fact, with but the briefest passing remark, the Board has thus far discounted the prospect that its proposal would have a significant impact upon a substantial number of small entities. While the Board claims that its proposal would not adversely impact small businesses, using the standard pro forma language and certification required by the Regulatory Flexibility Act ("RFA") at 5 U.S.C. 601 et seq., it is impossible for P&L to know what has prompted the Board to so conclude. More importantly, P&L disputes that conclusion. The proposed rules could have a major economic impact on many small railroads.

Just because the Board has stated that its proposal would have no significant impact on a substantial number of small entities does not make this the case. Here, the Board appears preliminarily to have certified that it need not engage in more detailed RFA analysis, perceiving somehow that its proposed rules will not have the requisite significant impact, but P&L respectfully submits that not even the most cursory of analyses has been done here. If the Board believes that its certification is correct, then, it must at least provide some support for its conclusion, especially in the face of evidence and argument to the contrary.[7]

As P&L has shown here, the proposed guidelines *would* have a significant economic impact on a substantial number of small entities. In that regard, if the Board's preliminary RFA certification was meant merely to test the assertion in a public forum, then P&L has joined the debate. The Board needs to consider carefully the impact of its proposal on small entities like Class II and III carriers. In doing so, the Board should clarify that the proposed modified guidelines will

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[7] See, e.g., Colorado ex rel. Colorado State Banking Bd. v. Resolution Trust Corp., 926 F.2d 931, 1991 U.S. App. LEXIS 1930 at *948 (10th Cir. 1991)

> [An agency's certification that a rule will not, if promulgated, have a significant economic impact on a substantial number of small entities] does not mean that an agency may disregard completely the RFA's requirements, or "ignore with impunity the effect of its rules upon small entities." Thompson v. Clark, 741 F.2d 401, 408 (D.C. Cir. 1984). "The agency's decision may still be overturned because of an analysis so defective as to render its final decision unreasonable, or, in the absence of any analysis, because of a failure to respond to public comment concerning the rule's impact on small entities." Michigan v. Thomas, 805 F.2d 176, 188 (6th Cir. 1986) (citing Thompson v. Clark, 741 F.2d at 408).

not apply to Class II and Class III carriers, given the difficulties of fairly applying the guidelines to cases that would involve smaller railroads.

CONCLUSION

P&L appreciates having the opportunity to share its comments with the Board. As it has noticed in its preliminary observations, P&L doubts that the existing guidelines are truly "broken" as the Board seems to presume. Cases are being brought under those guidelines and are being resolved amicably. This proves that the Board already has in place processes for rate disputes that are tenable and more likely to yield a negotiated settlement than are the Board's full-SAC processes. The Board should therefore be careful to ensure that it is not proposing guideline modifications that reduce the likelihood of settlement during mediation while at the same time adding regulatory burdens on smaller railroads and exposing those carriers' rates to unlawful regulatory scrutiny.

Respectfully submitted,

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Dated: February 26, 2007

BEFORE THE
SURFACE TRANSPORTATION BOARD

STB Ex Parte No. 646 (Sub-No. 1)

SIMPLIFIED STANDARDS FOR RAIL RATE CASES

EXHIBIT 1

VERIFIED STATEMENT
OF
WILLIAM J. BRENNAN, PHD

BEFORE THE
SURFACE TRANSPORTATION BOARD

STB Ex Parte No. 646 (Sub-No. 1)

SIMPLIFIED STANDARDS FOR RAIL RATE CASES

VERIFIED STATEMENT
OF
WILLIAM J. BRENNAN, PHD

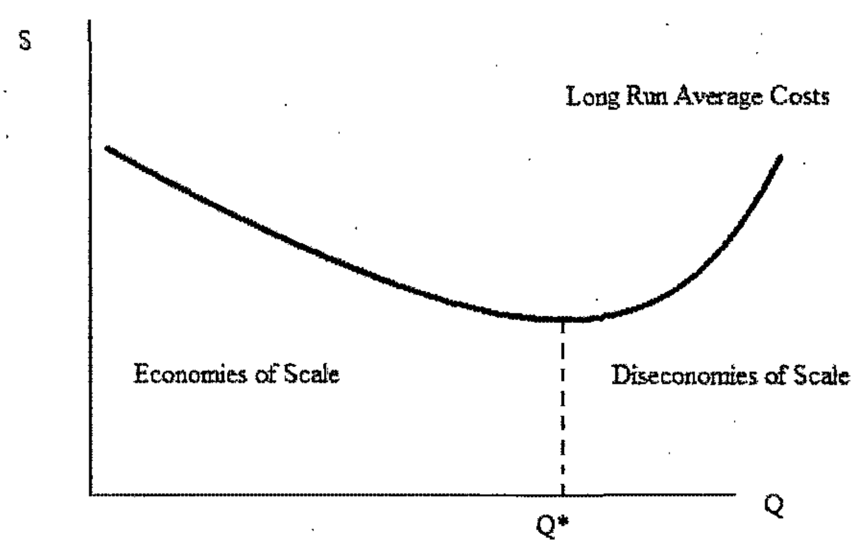
I. Introduction

I am William J. Brennan, PhD, Managing Director of Transportation Economics, Inc. ("TEI"), an economic consulting firm. At the request of Paducah & Louisville Railway, Inc. ("P&L"), I have reviewed the Board's proposal in this proceeding. P&L is concerned that the Board's proposal would unfairly regulate P&L's rates, and I believe that P&L's concerns are warranted. Both the current simplified standards and the Board's proposal contain significant biases against P&L, its sister companies, and the broader community of Class II and III carriers. As a result, the proposed standards would unlawfully allow certain rate challenges to proceed and could yield prescribed rates that are below the regulatory threshold or at levels below that required for P&L to maintain adequate revenues and recover its cost of capital. To demonstrate this point, I will rely on a few general (and generally unobjectionable) principles. I also will offer a few concrete suggestions that would be appropriate if the Board chooses to apply its proposed guidelines to short line and regional railroads.

II. URCS Greatly Understates Costs of Class II and III Carriers

The key flaw, both with the current guidelines and those proposed in Ex Parte 646 (Sub-No. 1), is reliance on regional URCS averages. The costs generated by URCS significantly understate the costs of regional and short line carriers, and this can be proven by applying the familiar tool of average cost curves.[1] The Board has on numerous occasions recognized that the railroad industry is characterized by substantial economies of scale, scope, and density.[2] Economies of scale exist when long-run average costs decline as output is increased. The presence of scale economies is depicted in Figure 1.

Figure 1: Scale Economies



In this figure, the long-run average cost curve is U-shaped. This implies that an

[1] Average costs are simply total costs divided by total output. An average cost curve is simply a graphical representation that shows the relationship between cost and output combinations.

[2] See, for example, the Board's decision in Major Issues in Rail Rate Cases, STB Ex Parte No. 657 (Sub-No. 1), (STB served Feb. 27, 2006), slip op. at 19.

expansion of output permits a carrier to produce at lower long-run average cost, as indicated between the origin and Q*.

However, because URCS was based on the cost and quantity combinations of Class I carriers only, the presence of scale economies implies (directly and inescapably) that URCS will understate the actual costs of much smaller carriers like P&L. Reliance on unadjusted regional URCS averages will improperly subject rates offered by smaller railroads to Board scrutiny.

From an econometric standpoint, the problem with URCS is that its estimates of unit costs and service units are *only valid within the range sample observations*, all of which were collected from the large Class I carriers. Given the presence of scale economies it would be inappropriate and unfair to conclude that URCS costs bear any relationship to the costs of carriers like P&L. This, too, can be demonstrated with a series of figures. Figure 2 shows a scatter plot of points, not unlike those observed when the Interstate Commerce Commission ("ICC") first estimated the URCS regression equations. Figure 3 shows a regression line like that which the ICC fitted through these observations using the least squares method. Figure 4 overlays the long run average cost curve and points out that, for a carrier like P&L, the (unobserved) average cost and output combination is likely to be much higher than that estimated by URCS.

Figure 2: Scatter Plot of Output and Average Cost Observations

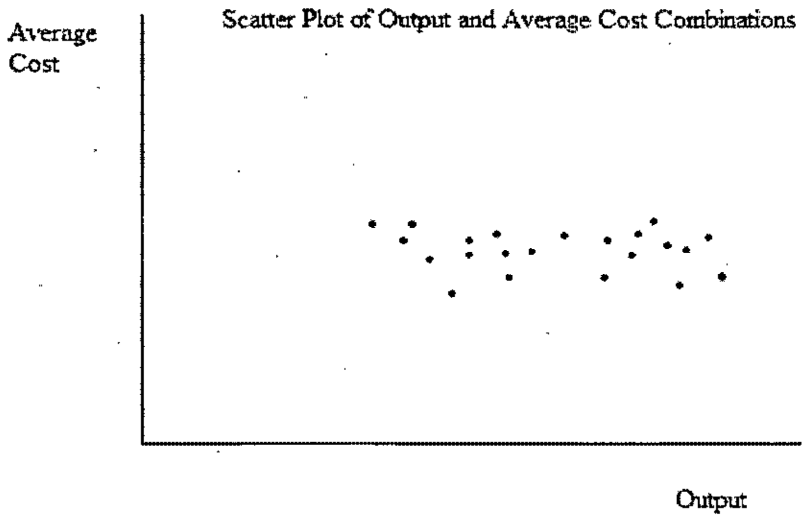


Figure 3: Scatter Plot with Regression Line

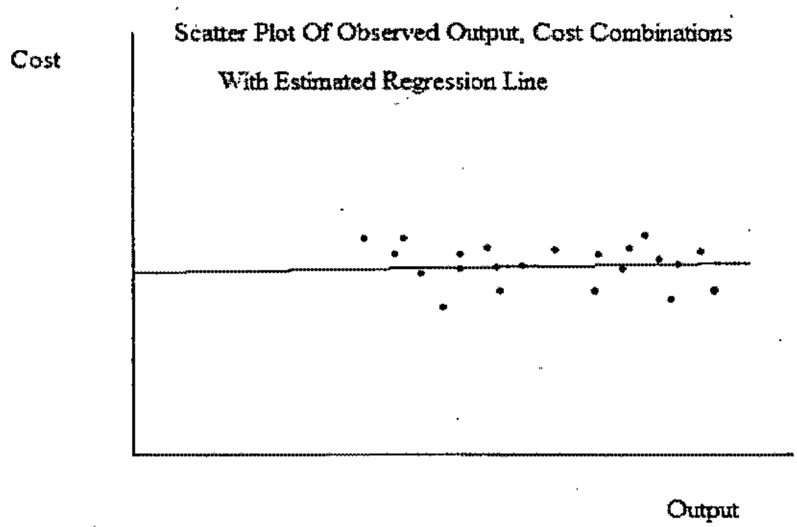
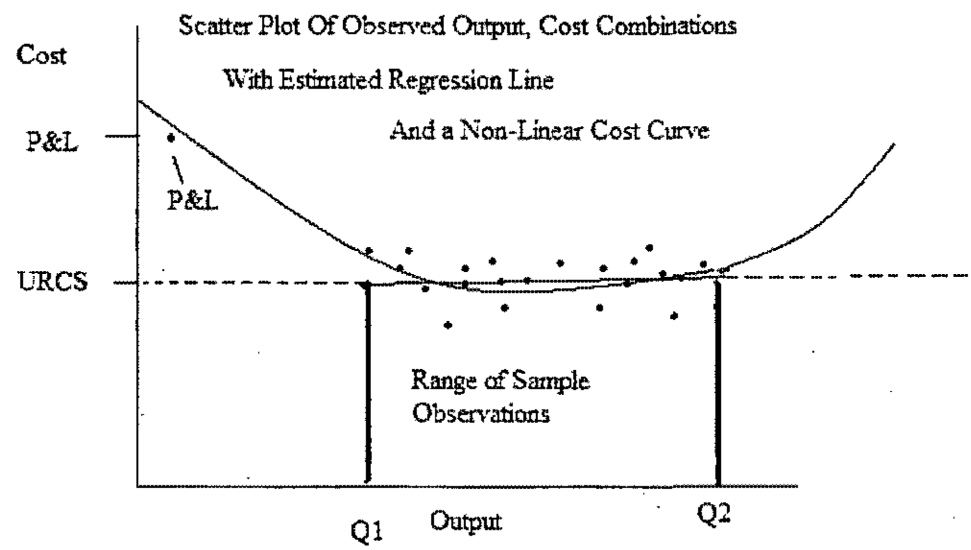


Figure 4: Scatter Plot with Regression Line and a Long Run Average Cost Curve



Because P&L is a Class II carrier, I placed a dot near the Y-axis depicting where we might plausibly find its output, average cost combination. Where scale economies are present, any carrier with low levels of output will have higher *average* costs than the Class I carriers. Not only will URCS understate the costs of these carriers, but it will also dramatically lower the jurisdictional threshold (the 1.8 markup over variable costs).

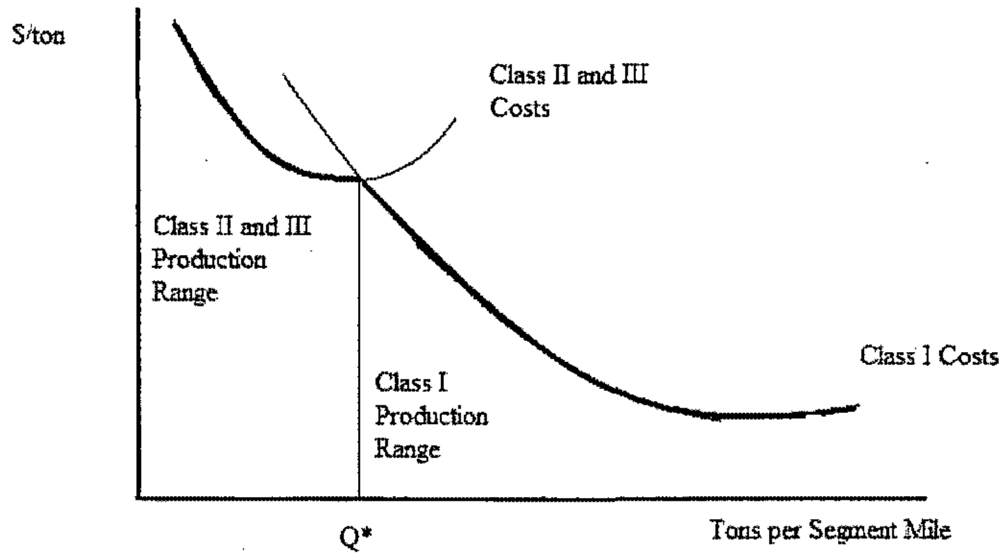
Although it might appear that one way to address some of these problems with URCS would be to allow train and operating characteristics that the Phase III Movement Costing Program is explicitly designed to accommodate, such a step would be of little help to Class II and III carriers. While such Phase III adjustments might produce more precise estimates of Class I costs, it is unlikely that they would do so for Class II and III carriers. One problem, highlighted by the comments of The Kansas City Southern Railway Company ("KCSR"), is that the Board relies on cost of capital derived from the four largest Class I carriers. If this practice is harmful to KCS, it is certainly harmful to short line and regional railroads. Because P&L is a smaller carrier closely tied to a particular geographic location and commodity mix, it is much more vulnerable to economic shocks than are the four largest Class I carriers. As a result of these higher risks, P&L (and other Class II and III carriers) likely face a higher cost of capital.

In addition, because they enjoy superior economies of scale, scope, and density, Class I railroads have evolved in ways that differ from their Class II and III brethren. Class I carriers are optimized to move large traffic blocks over substantial distances. (Indeed, the average length of haul for Class I carriers far exceeds the total miles of road operated by the typical Class II and III carrier). As a result, it might be better to think of Class I and non-Class I carriers as employing two different technologies. By this I mean to suggest that while all railroads may look alike (both employ locomotives and cars over the standard gauge), the ability of Class I carriers to combine inputs and produce outputs differs dramatically from that of non-Class I carriers.[3]

Once one considers the differences between larger and smaller carriers in this way, it becomes clear why both types of carriers can survive; they occupy different "niches." Because they enjoy superior economies of scale, scope, and density, Class I carriers are the lower-cost providers of rail service. Were it otherwise, most rail services would be provided by Class II and III carriers. Nevertheless, even though Class III carriers have higher costs on average, Class II and IIIs outperform their Class I counterparts on light density lines. This is depicted in Figure 5 where tons per segment mile fall below Q*.

[3] For a technical discussion of technology, see Varian, *Microeconomic Analysis* (1992) at 2-5.

Figure 5: Comparison of Average Cost Curves



Therefore, while P&L may provide service at lower cost than a Class I carrier in the range to the left of Q*, it will do so at a far higher cost than the regional URCS average. In addition, URCS's allocation of costs among the various activity categories will not accurately reflect how carriers like P&L function and incur costs.

Although URCS measures some time-based costs, it allocates most costs to mileage-based categories (like gross-ton miles or locomotive running miles). As a result, URCS does not accurately reflect the time-related and cost-intensive switching, pickup, and delivery costs that characterize Class II and III operations. Merely adjusting the Phase III Movement Costing Program to allow for train and operating characteristics would not, as discussed, eliminate the bias of applying URCS costs to smaller carriers. Rather, at a minimum, the Board should permit carriers like P&L to introduce evidence to show that their average costs would be higher than those generated by URCS.

III. Because it Depends on URCS, RSAM is Biased Against Smaller Railroads

The problems with relying on the URCS regional averages for carriers like P&L are not limited to the jurisdictional threshold inquiry. After all, the Board uses URCS to develop its Costed Waybill Sample, which forms the foundation for the Three Benchmark Method. However, because URCS understates the costs of carriers like P&L, *it will understate its revenue shortfall and bias the RSAM calculation downwards.* Such a distorted RSAM calculation might, at first blush, suggest that a challenged rate charged by a smaller railroad warrants remedial action when, in fact, application of a corrected RSAM calculation, using a more accurate cost calculation, would show that the rate merely reflects the legitimate application of differential pricing.

In 1992, the ICC recognized that RSAM sacrificed precision to minimize the cost of contesting a rate.[4] It is not clear that the ICC or the Board have ever recognized how large that imprecision is likely to be for Class II and III carriers. Therefore, it is essential – as the Commission promised in its RSAM decision – that parties "should have an opportunity to argue for adjustments due to special circumstances relating to the traffic under complaint."[5] (A footnote omitted from this quotation notes that "special circumstances" might include density of operations and special movement characteristics). As shown, the Board's proposal to rely on unadjusted URCS would bias both the jurisdictional inquiry and the RSAM benchmark against short line and regional railroads.

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[4] See, Rate Guidelines – Non-Coal Proceedings, ICC Ex Parte No. 347 (Sub-No. 2), (ICC served Nov. 16, 1992)

[5] See, Id., slip op. at 4.

Finally because URCS understates the expenses of Class II and III carriers relative to Class I carriers, it would be improper to include Class I movements in a comparison group when the rate of a Class II or III carrier is challenged in the small rail rate dispute process.

VERIFICATION

I, William J. Brennan, PhD, declare under the penalty of perjury that to the best of my knowledge the foregoing is true and correct. Further, I certify that I am qualified to file this Verified Statement. Executed this 20th day of February, 2007.

William J Brennan

William J. Brennan

CERTIFICATE OF SERVICE

I have this day served a copy of the foregoing Comments of Paducah & Louisville Railway, Inc., upon all other parties of record by depositing a copy in the U.S. mail in a properly addressed envelope with adequate first-class postage thereon prepaid, or by other, more expeditious means.

Dated: February 26, 2007

Crystal M. Zorbaugh